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Department of the Treasury

Washington, DC 20224

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CC:PSI:1-PLR-114144-00
Date:
Dec 20, 2000

Legend:

Trust =

Series 1 =

Series 2 =

Fund A =

Fund B =

Feeder Fund 1 =

Feeder Fund 2 =

Feeder Fund 3 =

Feeder Fund 4 =

Feeder Fund 5 =

State A =

State B =

State C =

D1 =

D2 =

D3 =

D4 =

This responds to the letter dated July 19, 2000 and subsequent correspondence, submitted by your representative on behalf of Series 2 requesting various rulings with respect to the formation of a master-feeder structure.

FACTS

Each of Feeder Fund 1 and Feeder Fund 2 is a separate series of Fund A. Fund A was formed as a business trust under the laws of State A on D1. Each of Feeder Fund 1 and Feeder Fund 2 is treated as a separate corporation for federal income tax purposes pursuant to section 851(g)(1). Each of Feeder Fund 1 and Feeder Fund 2 has elected to be and is qualified as a regulated investment company ("RIC") under sections 851 through 855, and intends to continue to so qualify.

Each of Feeder Fund 3 and Feeder Fund 4 is a separate series of Fund B. Fund B was formed as a corporation under the laws of State B on D2. Each of Feeder Fund 3 and Feeder Fund 4 is treated as a separate corporation for federal income tax purposes pursuant to section 851(g)(1). Each of Feeder Fund 3 and Feeder Fund 4 will elect to be and intends to qualify as a RIC under sections 851 through 855, and intends to continue to so qualify.

Feeder Fund 5 is a corporation organized under the laws of State C on D3.

Trust is a business trust organized under the laws of State C on D4 by filing a Certificate of Trust. A Declaration of Trust sets forth the terms of Trust ("Declaration"). Trust will be registered as an open-end management company under the Investment Company Act of 1940 (the "1940 Act"). Trust currently has two series, consisting of Series 1 and Series 2.

The taxpayers intend to create what is commonly referred to as a "master/feeder" structure. In creating this structure, Feeder Fund 1, Feeder Fund 3, and Feeder Fund 5 will contribute assets to Series 1 of Trust, and Feeder Fund 2, Feeder Fund 4, and Feeder Fund 5 will contribute assets to Series 2 of Trust. Feeder Fund 1 will contribute all of its assets, consisting of a diversified portfolio of securities and cash, to Series 1 in exchange for a beneficial interest in Series 1 approximately equal in value to the fair market value of assets transferred. Each of Feeder Fund 3 and Feeder Fund 5 will contribute cash or securities to Series 1 in exchange for a beneficial interest in Series 1 approximately equal in value to the fair market value of assets transferred. Feeder Fund 2 will contribute all of its assets, consisting of a diversified portfolio of securities and cash, to Series 2 in exchange for a beneficial interest in Series 2 approximately equal in value to the fair market value of assets transferred. Feeder Fund 2 and Feeder Fund 5 will contribute cash or securities to Series 2 in exchange for a beneficial interest in Series 2 approximately equal in value to the fair market value of assets transferred.

Each Feeder Fund represents that it will contribute only cash and/or a portfolio of diversified stocks and securities which satisfies the 25- and 50-percent tests of section 368(a)(2)(F)(ii), applying the relevant provisions of section 368(a)(2)(F). For purposes of this test, Government securities are not included within the meaning of "securities" under section 368(a)(2)(F)(ii), but are included within the meaning of "total assets" in section 368(a)(2)(F)(iv). Each Feeder Fund further represents that the adjusted basis and fair market value of the assets to be exchanged for interests in Trust will, in each instance, equal or exceed the sum of the liabilities to be assumed by Trust plus any liabilities to which the transferred assets are subject.

Cash contributed by Feeder Funds has been and will be used only to carry on the normal operating and investment activities of each respective Series. Normal operating activities would include payment of partnership level expenses and periodic withdrawals of partnership capital. Normal investment activities for Series 1 would consist only of holding itself out as a type of investment with an investment objective of maximizing long-term total returns and which invests in bonds of varying maturities with a portfolio duration of two to eight years. Normal investment activities for Series 2 would consist only of holding itself out as a type of investment with an investment objective of maximizing total returns consistent with preservation of capital and which invests in bonds of varying maturities with a portfolio duration of one to three years.

Taxpayers represent that any new Feeder Fund will meet the diversification requirements of sections 368(a)(2)(F)(ii) and 1.351-1(c)(6). For purposes of this test, Government securities are not included within the meaning of "securities" under section 368(a)(2)(F)(ii), but are included within the meaning of "total assets" in section 368(a)(2)(F)(iv). The adjusted basis and fair market value of the assets which any new Feeder Fund might exchange for an interest in Trust will equal or exceed the sum of the liabilities to be assumed by Trust plus any liabilities to which the transferred assets are subject.

Each Series will be treated as a partnership for federal tax purposes. The Feeder Funds are partners of each of the partnerships in which they invest. Each Feeder Fund is treated as a corporation for federal income tax purposes and will elect to be treated as a RIC under subtitle A, chapter 1, subchapter M of the Code. Thereafter, each Feeder Fund intends to operate in a manner that continues to qualify it as a RIC.

Beneficial interests in each Series will be issued solely in private placement transactions that do not involve any "public offering" within the meaning of section 4(2) of the Securities Act of 1933, as amended (the "1933 Act"). Neither Series will register its shares under the 1933 Act, because shares in each Series may be issued solely in private placement transactions that do not involve any "public offering" within the meaning of section 4(2) of the 1933 Act. Investments in each Series may only be made by entities registered under the 1940 Act which would be considered a "publicly offered regulated investment company" as defined in sections 67(c)(2)(B) and 1.67-2T(g)(3). The interest of each partner in each Series is limited to the net assets of that Series and does not extend to the assets of the other Series or of any other investment vehicles of Trust. Neither Series has invested in any of Trust's other investment vehicles.

Except as required by sections 704(c) and 1.704-1(b)(4), each partner will be allocated a pro rata share of partnership income, gain, loss, deduction and credit in accordance with the regulations under section 704(b). Each partner's initial capital account balance will be the amount of money and the fair market value of the property contributed to its Series by the partner. Under section 1.704-1(b)(2)(iv)(f), each Series will revalue its investment portfolios to fair market value as of the close of each day. Each Series will adjust its partners' individual capital accounts to reflect the partner's share of the net change in the value of its portfolio of assets from the close of the prior day to the close of the current day. Each Series represents that it qualifies as a securities partnership under section 1.704-3(e)(3)(iii), and that substantially all of its property will consist of readily tradeable securities. The burden to each Series of making section 704(c) allocations separate from reverse section 704(c) allocations is represented to be substantial.

Each Series represents that none of its contributions, revaluations and corresponding allocations of tax items was or will be made with a view to shifting the tax consequences of built-in gain or loss among its partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

Law, Analysis, & Conclusions

Ruling 1:

Each Series has requested a ruling that it will be treated as a separate partnership for Federal income tax purposes. Taxpayer has represented the following: pursuant to the law of State C in which Trust was formed and under Trust's Declaration, separate Series can be established under Trust; under State C law and Declaration, each Series should be treated as a separate and distinct entity with its own assets, income, and proceeds, as well as liabilities, costs, expenses, and losses.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an “eligible entity”) can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as an association or a partnership. Section 301.7701-3(b)(1) provides that a domestic eligible entity with two or more members will be classified as a partnership unless it elects otherwise.

Provided that each Series does not elect to be treated as an association taxable as a corporation, that Series will be treated as a separate partnership for Federal income tax purposes.

Ruling 2:

Each Feeder Fund has requested a ruling that it will be deemed to own a proportionate share of each of the assets of the Series in which it holds an interest, and will be deemed to be entitled to the income of such Series attributable to such Feeder Fund’s proportionate share for purposes of determining whether the Feeder Fund satisfies the requirements of sections 851(b)(2), 851(b)(3), 852(b)(5), 853, and 854.

Section 851(b) provides that certain requirements must be satisfied in order for a domestic corporation to be taxed as a RIC and thereby to be exempt from the corporate level tax on most income.

Section 851(b)(2) provides that, to qualify as a RIC, at least 90 percent of a corporation's gross income must be derived from dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), gains from the sale or other disposition of stocks, securities, foreign currencies, or other income derived with respect to the business of investing in such stocks, securities, or currencies.

Section 851(b)(3)(A) requires that, in order to qualify as a RIC, at the close of each quarter of the taxable year, at least 50 percent of the value of a corporation's total assets must be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer.

Section 851(b)(3)(B) provides that, in order to qualify as a RIC, not more than 25 percent of the corporation's total assets may be invested in the securities (other than Government securities and the securities of other RICS) of any one issuer, or of two or more issuers that the corporation controls and which are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

Section 852(b)(5) provides that a RIC at least 50% of the value (as defined in section 851(c)(4)) of whose total assets at the close of each calendar quarter consists of obligations described in section 103(a) is eligible to pay exempt-interest dividends, which are treated by the RIC's shareholders as interest excludable from gross income pursuant to section 103(a).

Section 853(a) provides that a RIC more than 50 percent of the value (as defined in section 851(c)(4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations and which meets the requirements of section 852(a) for the taxable year may elect to treat its shareholders as if they had paid certain foreign taxes incurred by the RIC for purposes of determining a shareholder's foreign tax credit under section 901.

Section 854(b)(1)(A) provides that a dividend, other than a capital gain dividend, received from a RIC qualifies for the dividends received deduction under section 243(a) to the extent so designated by the RIC provided that the RIC meets the requirements of section 852(a) for the taxable year during which it paid the dividend.

Section 854(b)(1)(B) provides that the aggregate amount that may be designated as dividends under section 854(b)(1)(A) shall not exceed the aggregate dividends received by the RIC for the taxable year.

Section 854(b)(3)(A) provides that the term "aggregate dividends received" includes only dividends received from domestic corporations.

Section 854(b)(4) provides, in part, that for purposes of determining an amount to be treated as a dividend eligible for the dividends received deduction under section 243 a payment to a RIC shall not be treated as a dividend unless, had it not been a RIC, it would have been allowed a dividends received deduction under section 243 with respect to the payment.

Section 702(b) provides that the character of items stated in section 702(a) that are included in a partner's distributive share shall be determined as if such items were realized directly from the source from which they were realized by the partnership, or incurred in the same manner as incurred by the partnership. Section 702(c) provides that where it is necessary to determine the amount or character of the gross income of a partner, such amount shall include that partner's distributive share of the gross income of the partnership.

Section 1006(n)(1) of the Technical and Miscellaneous Revenue Act of 1988 added a sentence to the flush language of section 851(b) that states that income derived from a partnership or trust shall be treated as satisfying the 90 percent test of section 851(b)(2) only to the extent that such income is attributable to items of income of the partnership or trust that would be described in section 851(b)(2) if earned directly by the RIC. The legislative history of that sentence indicates that it was intended to clarify the general rule used to characterize items of income, gain, loss, deduction, or credit includable in a partner's distributive share, as applied to RICs that are partners. It therefore explains the relationship of section 702 to the 90 percent test under section 851(b)(2). See S. Rep. No. 445, 100th Cong., 2d Sess. 93 (1988).

Under subchapter K, a partnership is considered to be either an aggregate of its members or a separate entity. Under the aggregate approach, each partner is treated as an owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is treated as a separate entity in which partners have no direct interest in partnership assets and operations. See S. Rep. No. 1622, 83d Cong., 2d Sess. 89 (1954); H.R. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954).

In order for a holder to qualify as a RIC under the diversification tests of section 851, the aggregate approach will have to be applied to each holder's partnership interest in a series. As an aggregate, each holder will be entitled to take into account its share of the individual items of income and assets of the series.

Rev. Rul. 75-62, 1975-1 C.B. 188, concerns a life insurance company that contributed cash to a partnership in exchange for a 50 percent interest in the partnership. The partnership held real estate as its principal asset. For the taxable year in question, section 805(b) required life insurance companies to value their assets each taxable year. For this purpose, section 805(b)(4) required that shares of stock and real estate be valued at their fair market values and that other assets be valued at their adjusted bases. The issue presented in the ruling is whether, for purposes of section 805(b)(4), the life insurance company's interest in the partnership is considered to be an investment in the real estate held by the partnership (an aggregate approach) or an investment in other property (an entity approach).

Rev.Rul. 75-62 holds that the partnership interest held by the life insurance company must be accounted for as other property for purposes of section 805(b)(4) of the Code. The ruling cites sections 705 and 741, both of which generally treat an interest in a partnership as an interest in an entity, as evidence of an intent in subchapter K to take the entity approach in questions concerning the nature of an interest in a partnership. The ruling states that the legislative history of section 805(b)(4) does not indicate that application of the entity approach to the facts of the ruling is inappropriate and that there is no compelling reason to take the aggregate approach.

The flush language of section 851(b) and its legislative history indicate that here, unlike the situation described in Rev. Rul. 75-62, Congress intended that an aggregate approach be taken in determining the nature of the partnership interests held by the Feeder Funds. The flush language of section 851(b) mandates an aggregate approach in applying the 90 percent gross income test of section 851(b)(2) to RICs that hold partnership interests. It would be anomalous to suggest that Congress intended that a RIC's interest in a partnership be viewed as a direct investment in the partnership's assets for purposes of the section 851(b)(2) test but not be viewed as a direct investment in those assets for purposes of the test set out in section 851(b)(3).

The tax treatment accorded real estate investment trusts (“REITs”) lends further support to applying the aggregate approach to the present case. REITs were created to provide an investment vehicle similar to the RIC for small investors to invest in real estate and real estate mortgages. See H.R. Rep. No. 2020, 86th Cong., 2d Sess. 3 (1960). Like RICs, REITs are subject to restrictions on the type of assets they can hold if they want to retain the benefits accorded them under subchapter M and are subject to certain gross income source tests. REITs and RICs also have similar distribution and holding period requirements.

Section 1.856-3(g) of the regulations provides that:

> In the case of a real estate investment trust which is a partner in a partnership, as defined in section 7701(a)(2) and the regulations thereunder, the trust will be deemed to own its proportionate share of each of the assets of the partnership and will be deemed to be entitled to the income of the partnership attributable to such share. For purposes of section 856, the interest of a partner in the partnership's assets shall be determined in accordance with his capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership shall retain the same character in the hands of the partners for all purposes of section 856. Thus, for example, if the trust owns a 30 percent capital interest in a partnership which owns a piece of rental property the trust will be treated as owning 30 percent of such property and as being entitled to 30 percent of the rent derived from the property by the partnership. Similarly, if the partnership holds any property primarily for sale to customers in the ordinary course of its trade or business, the trust will be treated as holding its proportionate share of such property primarily for such purpose. Also, for example, where a partnership sells real property or a trust sells its interest in a partnership which owns real property, any gross income realized from such sale, to the extent that it is attributable to the real property, shall be deemed gross income from the sale or disposition of real property held for either the period that the partnership has held the real property or the period that the trust was a member of the partnership, whichever is the shorter.

Thus, the regulation adopts the aggregate "look-through" approach in determining how a REIT should account for its partnership interests for purposes of all of the income and asset qualification tests under section 856.

The legislative purpose underlying the creation of both RICs and REITs was to provide small investors a means of pooling their resources to invest in a particular type of assets without the imposition of corporate income tax. The qualification tests are similar for each. Therefore, although the RIC regulations do not specifically address the issue herein, it is appropriate to adopt an approach for RICs that parallels that set forth for REITs.

Based on the information and representations submitted, we rule that each Feeder Fund that qualifies as a RIC and is a partner in a Series of Trust will be deemed to own a proportionate share of the assets of the Series in which it is a holder, and will be deemed to be entitled to the income of such Series attributable to that Feeder Fund's proportionate share for purposes of determining whether the Feeder Fund satisfies the requirements of sections 851(b)(2), 851(b)(3), 852(b)(5), 853, and 854 of the Code. For purposes of these sections, the interests of each Feeder Fund in the Series shall be determined in accordance with the Feeder Fund's capital interest in the Series.

This opinion is limited to Feeder Fund 1, Feeder Fund 2, Feeder Fund 3, Feeder Fund 4, and Trust. No opinion is expressed with respect to the federal income tax consequences of this transaction other than as concluded above. Specifically, no opinion is expressed as to whether Feeder Fund 1, Feeder Fund 2, Feeder Fund 3, or Feeder Fund 4 qualifies as a RIC that is taxable under subchapter M, part I of the Code.

Ruling 3:

The taxpayer has also requested a ruling that none of Series 1, Series 2, or Trust will be treated as a publicly traded partnership under section 7704. Section 7704(a) provides that a publicly traded partnership is treated as a corporation. Section 7704(b) and section 1.7704-1(a) provide that, under section 7704, the term "publicly traded partnership" means any partnership if interests in the partnership are (i) traded on an established securities market, or (ii) readily tradable on a secondary market or the substantial equivalent thereof.

Section 1.7704-1(c)(1) provides that interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable economically to trading on an established securities market.

Section 1.7704-1(h)(1) provides that interests in a partnership are not treated as readily tradable on a secondary market or the substantial equivalent thereof within the meaning of section 7704(b) if (i) all interests in the partnership were issued in a transaction (or transactions) that was not registered under the 1933 Act, and (ii) the partnership does not have more than 100 partners at any time during the taxable year.

Section 1.7704-1(h)(3) provides that, for section 1.7704-1(h)(1) a person who owns an interest in a partnership, grantor trust, or S corporation (flow-through entities) that owns, directly or through other flow-through entities, an interest in the partnership is treated as a partner in the partnership only if (i) substantially all of the value of the beneficial owner's interest in the flow-through entity is attributable to the flow-through entity's interest (direct or indirect) in the partnership, and (ii) a principal purpose of the use of the tiered arrangement is to permit the partnership to satisfy the 100-partner limitation of section 1.7704-1(h)(1)(ii).

Each of Series 1, Series 2, and Trust represents that the number of its interest holders will be limited to fewer than 100, and that no partnership, grantor trust, or S corporation described in section 1.7704-1(h)(3) of the Regulations will become an interest holder in Trust. Each further represents that no interests in Trust will be traded on an established securities market or issued in a transaction under the 1933 Act, because the interests in the Trust will not be required to be registered under the 1933 Act (private placement exception). Based on the information provided and the representations made, we conclude that none of Series 1, Series 2, or Trust will be treated as a publicly traded partnership for purposes of section 7704.

Ruling 4:

Taxpayers also have requested rulings that no gain or loss will be recognized by Trust, Series 1, Series 2, or any Feeder Fund upon a contribution of property to Trust by a Feeder Fund solely in exchange for shares of beneficial interest in Trust and Trust's assumption of the Feeder Funds' liabilities, if any.

Section 721(a) provides that no gain or loss is recognized to a partnership or any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(b) provides, however, that section 721(a) does not apply to gain realized on a transfer of property to a partnership that would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated.

Section 351 states that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. Section 351 does not apply to a transfer of property to an investment company. Section 351(e)(1).

Section 1.351-1(c)(1) of the Income Tax Regulations states that a transfer to an investment company will occur when (i) the transfer results, directly or indirectly, in diversification of the transferors' interests and (ii) the transferee is a RIC, a REIT, or a corporation more than 80percent of the value of whose assets (excluding cash and non-convertible debt obligations from consideration) are held for investment and are readily marketable stocks or securities, or interests in RICs or REITs.

Section 1002 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997) (the "1997 Act"), amends section 351(e) for transfers after June 8, 1997, in taxable years ending after such date, subject to certain transitional relief provisions. Section 1002 of the 1997 Act is intended to expand the types of assets considered in determining whether a transfer is to a transferee described in section 1.351-1(c)(1)(ii)(c) to include certain assets in addition to "readily marketable stocks or securities" and interests in RICs and REITs. However, the 1997 Act is not intended to alter the requirement of section 1.351-1(c)(1)(i) that a transfer of property will be considered to be a transfer to an investment company under section 351(e) only if the transfer results, directly or indirectly, in diversification of the transferors' interests. *See* S. Rep. 105-33, 105th Cong., 1st Sess. 131 (1997); H. R. Rep. 105-148, 105th Cong., 1st Sess. 447 (1997); H. R. Rep. 105-220, 105th Cong., 1st Sess. 516-17 (1997).

Section 1.351-1(c)(5) provides that a transfer ordinarily results in diversification of the transferors' interests if two or more persons transfer nonidentical assets to a corporation in the exchange. It further provides that, if a transfer is part of a plan to achieve diversification without recognition of gain, such as a plan which contemplates a subsequent transfer, however delayed, of the corporate assets (or of the stock or securities received in the earlier exchange) to an investment company in a transaction purporting to qualify for nonrecognition treatment, the original transfer will be treated as resulting in diversification.

Section 1.351-1(c)(6)(i) provides that (i) a transfer of stocks and securities will not be treated as resulting in a diversification of the transferors' interests if each transferor transfers a diversified portfolio of stocks and securities, and (ii) a portfolio of stocks and securities is considered to be diversified if it satisfies the 25 and 50 percent tests of section 368(a)(2)(F)(ii), applying the relevant provisions of section 368(a)(2)(F), except that government securities are included in total assets for purposes of the denominator of the 25 and 50 percent tests (unless acquired to meet the 25 and 50 percent tests), but are not treated as securities of an issuer for purposes of the numerator of the 25 and 50 percent tests.

A corporation is diversified within the meaning of section 368(a)(2)(F)(ii) if not more than 25 percent of the value of its total assets is invested in the stock and securities of any one issuer and not more than 50 percent of the value of its total assets is invested in the stock and securities of 5 or fewer issuers.

Provided that Series 1 and Series 2 are each treated as a partnership for purposes of section 721, we hold as follows: (1) The transfers by Feeder Fund 1, Feeder Fund 3 and Feeder Fund 5 to Series 1 are not transfers of property to a partnership that would be treated as an investment company (within the meaning of section 351) if Series 1 were incorporated, provided that these are the only transfers to Series 1 (except for transfers solely of cash and/or a diversified portfolio of stocks and securities, within the meaning of section 1.351-1(c)(6)(i)); and (2) The transfers by

Feeder Fund 2, Feeder Fund 4 and Feeder Fund 5 to Series 2 are not transfers of property to a partnership that would be treated as an investment company (within the meaning of section 351) if Series 2 were incorporated, provided that these are the only transfers to Series 2 (except for transfers solely of cash and/or a diversified portfolio of stocks and securities, within the meaning of section 1.351-1(c)(6)(i)).

Contributions solely of cash and/or a diversified portfolio of stocks and securities (within the meaning of section 1.351-1(c)(6)(i)) to Series 1 or Series 2 by new feeder funds will not cause any of the transfers described above to be treated as a transfer of property to a partnership (*i.e.*, Series 1 or Series 2) that would be treated as an investment company within the meaning of section 351 if the partnership were incorporated.

We express no opinion as to whether the transaction described above is part of a plan to achieve diversification without recognition of gain under section 1.351-1(c)(5). Furthermore, we express no opinion as to the consequences of other transfers to Series 1 or Series 2, either as to whether such other transfers would be "transfers to an investment company" or whether such other transfers would, when taken together with the transfers described above and any transfers of cash or assets to either Series by new feeder funds, cause those transfers to be considered "transfers to an investment company," except for transfers solely of cash and/or a diversified portfolio of stocks and securities.

Ruling 5:

Each Feeder Fund has requested a ruling that its total basis in the beneficial interest received in Trust will equal the total basis of assets transferred to Trust in exchange, decreased by any net liabilities assumed by Trust, or increased by any net liabilities assumed by the Feeder Fund.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Section 752(a) provides that any increase in a partner’s share of the liabilities of a partnership, or any increase in a partner’s individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership. Section 752(b) provides that any decrease in a partner’s share of the liabilities of a partnership, or any decrease in a partner’s individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership. Section 752(c) provides that for purposes of section 752, a liability to which a property is subject shall, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

Section 1.752-1(f) provides that if, as a result of a single transaction, a partner incurs both an increase in the partner's share of the partnership liabilities (or the partner's individual liabilities) and a decrease in the partner's share of the partnership liabilities (or the partner's individual liabilities), only the net decrease is treated as a distribution from the partnership and only the net increase is treated as a contribution of money to the partnership. Generally, the contribution to or distribution from a partnership of property subject to a liability or the termination of the partnership under section 708(b) will require that increases and decreases in liabilities associated with the transaction be netted to determine if a partner will be deemed to have made a contribution or received a distribution as a result of the transaction.

Taxpayers have represented that the adjusted basis and fair market value of the assets of each Feeder Fund will equal or exceed the sum of liabilities to be assumed by Trust. Based on this representation, along with the taxpayers' other representations, we conclude that each Feeder Fund's total basis in the beneficial interest received in Trust will equal the total basis of assets transferred to Trust in exchange, decreased by any net liabilities assumed by Trust, or increased by any net liabilities assumed by the Feeder Fund.

Ruling 6:

Each Feeder Fund also requests a ruling that its holding period in its interest in Trust will include the period during which the property exchanged was held by the Feeder Fund, provided that such property constitutes a capital asset as defined in section 1221 or property described in section 1231 on the date of the exchange. Section 1223(1) provides that where property received in an exchange acquires the same basis, in whole or in part, as the property surrendered in the exchange, the holding period of the property received includes the holding period of the property surrendered to the extent such surrendered property was a capital asset as defined in section 1221 or property described in section 1231. Thus we conclude that each Feeder Fund's holding period in its interest in Trust will include the period during which the property exchanged was held by the Feeder Fund, provided that such property constitutes a capital asset as defined in section 1221 or property described in section 1231 on the date of the exchange.

Ruling 7:

Each of Series 1 and Series 2 requests a ruling that its basis in the assets received from a Feeder Fund will equal the basis of such property in the hands of such Feeder Fund immediately prior to the exchange. Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount, if any, of gain recognized under section 721(b) to the contributing partner at such time. Thus we conclude that the basis of assets contributed to Series 1 or Series 2 by any Feeder Fund will equal the basis of such assets in the hands of such Feeder Fund immediately prior to the exchange.

Ruling 8:

Each of Series 1 and Series 2 also requests a ruling that its holding period in the assets received from a Feeder Fund will include the period during which that Feeder Fund held those assets. Section 1.723-1 of the Income Tax Regulations provides that because property contributed to a partnership has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner. Thus we conclude that the holding period in assets received from a Feeder Fund by either Series 1 or Series 2 will include the period during which that Feeder Fund held those assets.

Ruling 9:

Series 1, Series 2, and each Feeder Fund have requested a ruling that the method employed by Series 1 and Series 2 of aggregating gains and losses from qualified financial assets for the purpose of making reverse section 704(c) allocations is reasonable within the meaning of section 1.704-3(e)(3).

Section 704(c)(1)(A) provides that income, gain, loss, and deduction with respect to property contributed to the partnership by a partner is shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

Section 1.704-3(a)(1) states that the purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to precontribution gain or loss. Under section 704(c), a partnership must allocate income, gain, loss, and deductions with respect to property contributed by a partner to the partnership so as to take into account any variation between the adjusted tax basis of the property and its fair market value at the time of the contribution. This allocation must be made using a reasonable method that is consistent with the purpose of section 704(c).

Section 1.704-3(a)(6) provides that the principles of section 1.704-3 apply to allocations with respect to property for which differences between book value and adjusted tax basis are created when a partnership revalues partnership property under section 1.704-1(b)(2)(iv)(f) (reverse section 704(c) allocations). A partnership that makes allocations with respect to revalued property must use a reasonable method that is consistent with the purposes of sections 704(b) and (c).

Section 1.704-3(a)(2) indicates that section 704(c) generally applies on a property-by-property basis. Therefore, in determining whether there is a disparity between adjusted tax basis and fair market value, the built-in gains and built-in losses on items of contributed or revalued property generally cannot be aggregated.

Section 1.704-3(e)(3) sets forth a special rule allowing certain securities partnerships to make reverse section 704(c) allocations on an aggregate basis. Specifically, section 1.704-3(e)(3)(i) provides that, for purposes of making reverse section 704(c) allocations, a securities partnership may aggregate gains and losses from qualified financial assets using any reasonable approach that is consistent with the purposes of section 704(c). Once a partnership adopts an aggregate approach, the partnership must apply the same aggregate approach to all of its qualified financial assets for all taxable years in which the partnership qualifies as a securities partnership.

Section 1.704-3(e)(3)(iii)(A) defines a securities partnership as a partnership that is either a management company or an investment partnership, and that makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner who provides management services or investment advisory services to the partnership). Under section 1.704-3(e)(3)(iii)(B)(1), a partnership is a management company if it is registered as a management company under the 1940 Act.

Section 1.704-3(e)(3)(ii) defines qualified financial assets as any personal property (including stock) that is actively traded, as defined in section 1.1092(d)-1 (defining actively traded property for purposes of the straddle rules). For a management company, qualified financial assets also include the following, even if not actively traded: shares of stock in a corporation; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in, any security, currency, or commodity, including any option, forward or futures contract, or short position; or any similar financial instrument.

Section 1.704-3(e)(3)(iv) and (e)(3)(v) describe two approaches to making aggregate reverse section 704(c) allocations that are generally reasonable -- the partial netting approach and the full netting approach. However, section 1.704-3(e)(3)(i) provides that other approaches may be reasonable in appropriate circumstances.

Section 1.704-3(e)(3)(v) (the full netting approach) provides that to use the full netting approach, the partnership must establish appropriate accounts for each partner for the purpose of taking into account each partner's share of the tax gains and losses. Under the full netting approach, on the date of each capital account restatement, the partnership: (A) nets its book gains and book losses from qualified financial assets since the last capital account restatement and allocates the net amount to its partners; (B) nets tax gains and tax losses from qualified financial assets since the last capital account restatement; and (C) allocates the net tax gain (or net tax loss) to the partners in a manner that reduces the book-tax disparities of the individual partners.

Section 1.704-3(a)(10) provides that an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequence of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

Furthermore, section 1.704-3(e)(3)(vi) provides that the character and other tax attributes of gain or loss allocated to the partners under an aggregate approach must: (A) preserve the tax attributes of each item of gain or loss realized by the partnership; (B) be determined under an approach that is consistently applied; and (C) not be determined with a view to reducing substantially the present value of the partners' aggregate tax liability. Each Series has represented that its allocations have complied and will comply with section 1.704-3(e)(3)(vi).

Each Series has elected to use the aggregate method for making reverse section 704(c) allocations described in section 1.704-3(e)(3)(v).

Both Series and Feeder Funds also have requested permission to aggregate built-in gains and losses from qualified financial assets later contributed to a Series by a partner with built-in gains and losses from revaluations of qualified financial assets held by that Series for the purpose of making section 704(c) and reverse section 704(c) allocations.

The aggregation rule of section 1.704-3(e)(3) applies only to reverse section 704(c) allocations. Therefore, a securities partnership using an aggregate approach must generally account for any built-in gain or loss from contributed property separately. The preamble to section 1.704-3(e)(3) explains that the final regulations do not authorize aggregation of built-in gains and losses from contributed property with built-in gains and losses from revaluations because this type of aggregation can lead to substantial distortions in the character and timing of income and loss recognized by contributing partners. T.D. 8585, 1995-1 C.B. 120, 123. However, the preamble also recognizes that there may be instances in which the likelihood of character and timing distortions is minimal and the burden of making section 704(c) allocations separate from reverse section 704(c) allocations is great. Consequently, section 1.704-3(e)(4)(iii) authorizes the Commissioner to permit, by published guidance or letter ruling, aggregation of qualified financial assets for purposes of making section 704(c) allocations in the same manner as that described in section 1.704-3(e)(3).

In this case, the burden to each Series of making section 704(c) allocations separate from reverse section 704(c) allocations is represented to be substantial. In addition, the likelihood that this type of aggregation could be abused by the Series and their partners is minimal. It is represented that each Feeder Fund will qualify as a "publicly offered regulated investment company" as defined in sections 67(c)(2)(B) and 1.67-2T(g)(3)(ii) (a "Qualified Contributor").

After applying the relevant law to the facts presented and the representations made, we conclude that each Series may aggregate built-in gains and losses from qualified financial assets contributed by its partners with built-in gains and losses from revaluations of qualified financial assets held by that Series for purposes of making section 704(c)(1)(A) and reverse section 704(c) allocations and that the method used by each Series for making section 704(c)(1)(A) and reverse section 704(c) allocations is reasonable, provided that a contribution or revaluation of property and the corresponding allocation of tax items with respect to the property are not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability and that each of the partners is a Qualified Contributor.

Ruling 10:

All of Series 1, Series 2, and Feeder Funds also have requested permission to use both Series' methods for making section 704(c) allocations, including reverse allocations, for Qualified Contributors that become partners in either Series.

It is anticipated that Qualified Contributors may become partners in either Series in the future. These new partners may contribute securities with built-in gain or loss to that Series, but only securities consistent with the investment objective of that Series.

After applying the relevant law to the information and representations submitted, we rule that each the method used by each Series for making section 704(c) allocations, including reverse allocations, for new partners who invest in that Series is a reasonable method within the meaning of section 1.704-3(a)(1), and is permitted by the Commissioner under section 1.704-3(e)(4)(iii), provided that: (i) a contribution or revaluation of property and the corresponding allocation of tax items with respect to the property are not made with a view to shifting the tax consequences of built-in gain or loss among the partnership in a manner that substantially reduces the present value of the partners' aggregate tax liability: (ii) the partner is registered as an open-end management company under the 1940 Act and is a Qualified Contributor; and (iii) to the extent a Series relies on this ruling with respect to the contribution, that Series will document any such contribution on its tax return filed subsequent to the contribution.

Rulings nine and ten are limited to allocations of gain or loss from the sale or other disposition of qualified financial assets made under sections 704(b), 704(c)(1)(A), and 1.704-3(a)(6). Specifically, no opinion is expressed concerning (i) whether any Feeder Fund qualifies as a RIC that is taxable under subchapter M, part I of the Code, (ii) allocations of items other than items of gain or loss from the sale or other disposition of qualified financial assets, or (iii) the aggregation of built-in gains and losses from qualified financial assets contributed to either Series by any partner other than the Feeder Funds and future new partners that qualify as Qualified Contributors. In addition, each Series must maintain sufficient records to enable it and its partners to comply with sections 704(c)(1)(B) and 737.

Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, any transaction(s) that are not specifically covered by the above rulings. Specifically, we express no opinion on the propriety of any of the rulings herein with respect to the contribution and subsequent admission of additional partners in Trust which are not specifically included in any representation given by the taxpayer.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in the ruling. *See* section 12.04 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, 46 (January 3, 2000). However, when the criteria in section 12.05 of Rev. Proc. 2000-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with our office, a copy of this letter will be sent to your authorized representative.

Sincerely,
David R. Haglund
Senior Technician Reviewer, Branch 1
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes